

## KAPT DISCLOSURE STATEMENT

FOR FALL 2004 ENROLLMENT PERIOD  
AUGUST 23, 2004, TO DECEMBER 13, 2004

See the KAPT website, [www.getKAPT.com](http://www.getKAPT.com), for additional information.

This Disclosure Statement summarizes the provisions relating to the purchase of prepaid tuition contracts from the Commonwealth Postsecondary Education Prepaid Tuition Trust Fund ("Fund") which is marketed under the name Kentucky's Affordable Prepaid Tuition or ("KAPT"), a public instrumentality of the Commonwealth of Kentucky (the "Commonwealth"). This Disclosure Statement is provided in connection with the enrollment period identified above. KAPT has been established to assist purchasers to pay for tuition at Kentucky postsecondary educational institutions on a tax-advantaged basis. The purposes of the Fund are: (1) to provide affordable access to participating postsecondary educational institutions for qualified beneficiaries and (2) to provide students and their parents economic protection against rising tuition costs.

**Purchasers are strongly urged to read this Disclosure Statement before purchasing a KAPT prepaid tuition contract. This Disclosure Statement is not intended to be a definitive or comprehensive statement of the terms and conditions of a KAPT prepaid tuition contract, and this Disclosure Statement is not part of the contract. Each statement herein is subject to qualification in its entirety by the terms and conditions of the KAPT Master Agreement, KAPT regulations, and applicable federal and state law.**

**You should consult your own tax and legal advisors before purchasing a KAPT Contract. This Disclosure Statement should not be considered legal advice; it does not take into account the individual tax or financial circumstances of a prospective purchaser.**

### SECURITIES LAW.

KAPT Contracts have not been registered with the U.S. Securities and Exchange Commission or with any state securities commission. Neither the U.S. Securities and Exchange Commission nor any state securities commission has approved or disapproved KAPT Contracts or reviewed or approved this Disclosure Statement. This Disclosure Statement does not constitute an offer to sell, or a solicitation of an offer to buy, a security.

KAPT Contracts are not bank deposits or savings accounts, and they are not insured by the Federal Deposit Insurance Corporation (FDIC), any governmental unit, insurance company, private person, or the Commonwealth. Under Kentucky Revised Statutes ("KRS") 393.015, 75 percent of the balance of the abandoned property fund administered by the Kentucky State Treasurer would be available in the event of any unfunded liability of the Fund, as may be determined by the KAPT Board. KAPT Contracts are not debts or obligations of, nor are they guaranteed by, the federal government, the Commonwealth, or any bank or financial institution.

Information contained in this Disclosure Statement, Enrollment Booklet, KAPT's website, Welcome Kit, and Master Agreement comprises the only information authorized by KAPT for a purchaser's review regarding KAPT Contracts. Purchasers should also review KAPT regulations published at 11 KAR 17:010 to 11 KAR 17:110 which may be viewed at the KAPT website. Purchasers should consult a tax consultant or advisor regarding acquisition of a KAPT Contract and corresponding availability for KAPT benefits. No one is authorized to provide information regarding KAPT which is different from the information contained in this Disclosure Statement and the KAPT Welcome Kit.

In order to purchase prepaid tuition credits for the fall 2004 enrollment period, you must submit an application between August 23, 2004, and December 13, 2004. Applications to join KAPT are available by request to the KAPT Headquarters, KHEAA, P.O. Box 798, Frankfort, Kentucky 40602; by calling 1-888-919-KAPT; or by visiting [www.getKAPT.com](http://www.getKAPT.com).

This Disclosure Statement presents only a summary of the features of the KAPT program. The legal terms and conditions for payment of benefits are governed by the Master Agreement, applicable Kentucky law, and KAPT regulations published at 11 KAR 17:010 to 11 KAR 17:110. A KAPT prepaid tuition contract consists of the purchaser's application, Master Agreement, Terms and Conditions of Payment and Purchase, KAPT regulations, and applicable federal and state law (collectively, the "KAPT Contract"). All benefits payable under the KAPT program will be made in

accordance with the purchaser's KAPT Contract. You should carefully read these legal documents in addition to this Disclosure Statement because they create binding legal obligations.

The terms and features of KAPT in subsequent enrollment periods may differ from the terms and features described in this Disclosure Statement. There is no assurance that additional enrollment periods will take place. In addition, the KAPT Board ("Board") may limit the number of purchasers who may join the KAPT program in any given enrollment period.

For purposes of this Disclosure Statement, the following terms shall be defined as follows: Participating individuals in the KAPT program who purchase a KAPT Contract are "purchasers." Each KAPT Contract has a single beneficiary selected by the purchaser, the "beneficiary."

#### THE FUND.

The Kentucky General Assembly created the Fund during its 2000 regular session, and the Fund is governed under KRS 164A.700-164A.709 and 393.015.

The Fund is governed by an 11-member Board, consisting of five members who hold state office, three members appointed by the Kentucky Treasurer, and three members appointed by the Governor of Kentucky. The state ex-officio members include the State Treasurer, who also acts as Chairman of the Board; the Secretary of the Kentucky Finance and Administration Cabinet; the Chair of the Association of Independent Kentucky Colleges and Universities; and the President of the Kentucky Council on Postsecondary Education. The Executive Director of the Kentucky Higher Education Assistance Authority acts as a non-voting member of the Board. Under Kentucky law, the members of the Board must have experience in finance, accounting, and investment management. Members of the Board receive no compensation but are reimbursed for actual expenses incurred in the performance of their Board duties. KAPT is administered by the Kentucky Higher Education Assistance Authority (KHEAA). KHEAA is a Kentucky State Government Agency that administers scholarships, grants, work-study, savings, and Federal Family Education Loans for higher education. For more information about KHEAA, visit [www.kheaa.com](http://www.kheaa.com). KAPT's Executive Director is responsible for the daily administration and operations of the KAPT program.

For information about the Fund's recordkeeper, investment manager, investment consultant, and actuary, please call 1-888-919-KAPT, option 3.

#### PROGRAM RISKS.

The following is a list of some of the factors, risks, and contingencies which purchasers should consider before purchasing a KAPT Contract.

Long-Term Investment. The purchase of a KAPT Contract is a long-term investment. Under the program if a contract is voluntarily terminated by the purchaser prior to July 1 of the beneficiary's initial projected year of enrollment, the purchaser may receive a refund only in the amounts actually paid for the KAPT Contract. Generally, no payment is made by the Fund until a beneficiary enrolls in a postsecondary institution. Also, KAPT may pay any refund in installments, meaning that a purchaser would not have immediate access to a cash refund.

Purchasers and beneficiaries are not entitled to receive a benefit from any investment returns of the Fund which exceed the Fund's obligations to pay prepaid tuition. Future Fund tuition obligations are established by calculating estimated future Kentucky tuition costs based on current costs and actuarial and investment performance assumptions. These projections are used to determine the prices for KAPT tuition plans. In the event one or more of the underlying assumptions proves to be inaccurate, the Fund may be unable to perform its obligations under the KAPT Contracts. Importantly, one of the primary factors affecting the Fund's ability to satisfy its obligations under KAPT Contracts is the Fund's attainment of a sufficient return on its investments.

The Fund's current investment policies provide for a targeted total rate of return based on an actuarial determination of the rate of return which is needed to enable the Fund to meet its obligations given current KAPT Contract pricing and projected enrollment dates. KAPT makes no representation, express or implied, or any assurance or

guarantee that future investment returns will equal or exceed targeted investment returns established by the Board. If the investment return of the Fund's assets were to fall short of its targeted level for a sustained period of time, the Fund's ability to perform its contract obligations could be significantly impaired. An important additional consideration is that pursuant to KRS 393.015, 75 percent of the abandoned property fund administered by the Kentucky State Treasurer would be available to meet any unfunded liability of the Fund, as may be determined by the Board.

No Guarantee of Admission. KAPT provides no assistance and makes no representation or guarantee, express or implied, to a beneficiary with respect to admission, continued enrollment at, or graduation from a college or university. KAPT's benefits are limited to the Fund's payment of tuition and mandatory fees as described in the purchaser's KAPT Contract. Purchase of a KAPT Contract does not guarantee college admission, continued enrollment, or graduation, or that a student will qualify for in-state tuition rates at a particular postsecondary institution. Finally, if a beneficiary does not attend a postsecondary educational institution and the KAPT Contract is not transferred to a family member (see discussion below), then full contract benefits may not be available.

Limited Substitution of Beneficiaries. If the beneficiary designated on the purchaser's application does not attend a postsecondary educational institution, the purchaser may be eligible to substitute another beneficiary according to KAPT regulations (see discussion below). However, substitution of a beneficiary whose projected enrollment date is later than that of the initial beneficiary will not result in any refund of contract payments or earnings realized by the Fund in respect of such payments. A purchaser may request substitution of a beneficiary with a projected enrollment date which is earlier than the initial projected enrollment date; in such case, the purchaser may be required to pay additional amounts resulting from a change in enrollment date to properly fund the amended contract.

Lack of Contract Transferability. KAPT Contracts may not be resold under any circumstances. A purchaser may transfer funds from his prepaid tuition account to another qualified tuition program under Code Section 529 in accordance with KAPT regulations. The Fund makes no representation, express or implied, that a purchaser will be able to transfer his Contract.

#### BUYING TUITION BENEFITS.

To purchase KAPT prepaid tuition benefits, you must file an application with KAPT during an open enrollment period. Individuals may participate in KAPT regardless of income level or age, and KAPT is open to purchasers wherever they reside. Individuals, trusts, corporations, partnerships and other legal entities may purchase contracts; Uniform Transfers to Minors Act (UTMA) accounts may also be used to fund the purchase of KAPT benefits. A purchaser does not have to be related to the beneficiary. There may only be one purchaser, and the purchaser may make changes to or cancel the contract only in accordance with the purchaser's KAPT Contract.

Payments to KAPT may be made by the purchaser or any other person; all payments by someone other than the purchaser become the property of the Fund subject to the terms of the KAPT Contract regardless of the relationship to the purchaser or identity of the contributor. KAPT benefits may only be used to fund the tuition costs for one beneficiary of the prepaid tuition account. The initial beneficiary must be selected by the purchaser on his application.

A purchaser's application will be accepted or denied by KAPT based upon conditions set forth in KAPT regulations. A non-refundable application processing fee of \$50 must accompany the application. Only payments in cash equivalents may be made by the purchaser, and in certain cases payroll deduction may be available for payment to KAPT. The beneficiary must be a resident of Kentucky at the time the contract is purchased, or if a beneficiary is a nonresident, the purchaser must indicate on his application that the nonresident beneficiary intends to attend an eligible educational institution in Kentucky. Finally, the beneficiary's proposed enrollment date must be no sooner than two years from the first payment due date of the contract.

The price for prepaid tuition benefits charged by KAPT for an open enrollment period is determined actuarially. Pursuant to Kentucky law, the Board is required to obtain actuarial assistance in order to establish, maintain, and certify funds sufficient to defray the obligations of the Fund. This actuarial determination is to be completed annually. After the actuarial evaluation is completed, the Board determines, based on such actuarial valuation, the purchase price of KAPT Contracts charged during an open enrollment period to ensure the actuarial soundness of the Fund. Based upon the Fund's annual actuarial valuation and increases in tuition and mandatory fees at applicable institutions together with

investment performance of the KAPT Fund, the Board may adjust the price of KAPT Contracts for subsequent open enrollment periods in order to maintain the actuarial soundness of the Fund.

#### CONTRACT BENEFITS.

KAPT Contracts are designed, primarily, for the purpose of prepaying in-state rates of undergraduate tuition and mandatory fees at two- and four-year public institutions of higher education in Kentucky (Kentucky Public Institutions) as identified in the Value and Standard Plans. KAPT Contracts create an obligation of the Fund to pay a beneficiary's in-state undergraduate tuition and all mandatory fees required as a condition of full-time enrollment at any Kentucky Public Institution for the specified number of academic terms purchased under the Value Plan or the Standard Plan. Full-time enrollment is defined as 16 semester hours for purposes of calculating the value of a prepaid tuition account. When the full purchase price has been paid and the qualified beneficiary has enrolled, the Fund is contractually committed to pay the tuition costs for full-time enrollment and mandatory fees of the beneficiary. In other words, the tuition cost guarantee may be purchased by selecting either the Value Plan or the Standard Plan.

Mandatory fees are those fees required as a condition of enrollment of all students for full-time enrollment in an undergraduate program. Unless a purchaser has excess tuition benefits (explained below), the Fund does not cover any other costs or fees that a student is obligated to pay; for example, mandatory fees do not include individual fees related to participation in a particular sport or activity, individual course fees such as laboratory fees or special academic program fees, books, or room and board. Payment options, features, and the list of Kentucky Public Institutions under the Value Plan and Standard Plan are included in KAPT's Enrollment Booklet.

The Premium Plan aims to help families cover the average cost of tuition at Kentucky private, accredited colleges and universities (Kentucky Private Institutions). Under the Premium Plan, KAPT's payment of tuition is based on the annual rates of increase in tuition costs at the University of Kentucky—not actual tuition costs at a private institution—and KAPT does not guarantee payment to cover full tuition at a private institution under the Premium Plan. A beneficiary who attends an educational institution other than a Kentucky Public Institution is responsible for paying the amount by which his actual tuition cost exceeds the amount of the value of his prepaid tuition account. **Importantly, the Fund does not guarantee full payment of tuition at any Kentucky Private Institution.** Also, a beneficiary who attends a Kentucky Public Institution but who does not qualify for the in-state tuition rate is responsible for paying the amount by which the out-of-state tuition cost exceeds in-state tuition. For more details and payment options, please refer to the KAPT Enrollment Booklet.

If not used for Kentucky institutions, Contract benefits may be used toward the cost of tuition and qualified higher education expenses if a qualified beneficiary attends an out-of-state postsecondary educational institution. In addition, if the value of a purchaser's prepaid tuition account exceeds the actual costs of tuition and mandatory fees, then such unused tuition benefits may be applied for payment of other qualified higher education expenses, including graduate school tuition and fees. Qualified higher education expenses include tuition, fees, books, supplies, and equipment required for enrollment as well as room and board if the beneficiary is enrolled at least half time. Payments for tuition and mandatory fees are made directly to eligible educational institutions.

The value of KAPT prepaid tuition benefits is not used in calculating personal asset contribution for determining eligibility and need for student loan programs, student grant programs, or other student aid programs administered by any agency of the Commonwealth, except as otherwise may be provided under federal law. For federal need-based financial aid, the receipt of KAPT Contract benefits is currently treated as a financial resource of the beneficiary and may affect a beneficiary's eligibility for financial aid.

#### SUBSTITUTION OF BENEFICIARY, CHANGES TO TUITION PLAN, AND TRANSFER OF CONTRACT RIGHTS.

Purchasers may change their beneficiary designation consistent with Internal Revenue Code Section 529 (26 U.S.C. 529). For example, under current Tax Code requirements, the new beneficiary must be a member of the family of the original beneficiary. Purchasers should carefully review applicable tax rules regarding changes of a beneficiary. In addition, as provided in the Master Agreement, a purchaser may change from one KAPT tuition plan to another, and in limited circumstances and with the approval of KAPT, KAPT Contract rights may be transferred in the event of a

purchaser's death, disability, or marital dissolution. Finally, a purchaser may request transfer of his prepaid tuition account to another qualified tuition program; any such transfer will be made in accordance with 26 U.S.C. 529 and KAPT regulations. For more detailed information concerning substitution, transfer, and conversion, please see the Master Agreement and applicable KAPT regulations.

#### FUNDING AND ACTUARIAL ASSUMPTIONS.

KAPT's funding is derived from contract purchasers and the investment income earned by the Fund. Interest and income earned from the investment of such funds remain in and are credited to the Fund. The Board has engaged a third-party investment manager to invest and manage the Fund. Assets of the Fund constitute public funds and may be invested in any security which constitutes legal investments of public funds. No purchaser or beneficiary may direct the investment of any contributions to the Fund or related earnings. Any favorable investment results accrue to KAPT and do not result in a direct benefit to purchasers or beneficiaries or increase in the value of their prepaid tuition accounts or a refund of payments. The Fund's investment purpose is to seek to earn rates of return that exceed anticipated tuition inflation rates so that the Fund meets its obligations to pay prepaid tuition in future years. KAPT Contracts do not obligate any general revenue of the Commonwealth and are not backed by the full faith and credit of the Commonwealth. However, 75 percent of the balance of the abandoned property fund administered by the Kentucky State Treasurer would be available to meet any unfunded liability of the Fund, as may be determined by the Board.

#### UTMA ACCOUNTS.

Under the Kentucky Uniform Transfers to Minors Act (UTMA), a person may make an irrevocable transfer to a minor beneficiary, and the transferor retains control of transferred custodial property—subject to a standard of care under UTMA—until the minor beneficiary attains age of majority, age 18 in Kentucky. KAPT will accept UTMA funds or funds under other states' laws (sometimes referred to as Uniform Gifts to Minors Act or "UGMA" accounts) for purchase of a KAPT Contract. UTMA/UGMA accounts involve additional restrictions and obligations which do not apply to other KAPT Contracts. If you are considering using a UTMA/UGMA account for such purchase, you should consult your legal advisor to determine if applicable state law permits use of UTMA/UGMA accounts for this purpose and to discuss your ongoing responsibilities under UTMA/UGMA following purchase of a KAPT Contract.

Under Kentucky law, a UTMA transfer is an indefeasible gift to the minor beneficiary, and following transfer the transferor is considered the UTMA custodian for purposes of UTMA law and for use of KAPT Contract benefits. The UTMA custodian, further, remains subject to a standard of care under UTMA in dealing with a KAPT Contract. Under Kentucky law, a UTMA custodian must transfer custodial property to the beneficiary upon attainment of age 18. In effect, this means that all rights under the KAPT Contract, including the ability to request a refund, would become exercisable, without restriction, by the KAPT beneficiary at age 18.

Typically, UTMA/UGMA accounts are subject to the following additional requirements and restrictions:

- The UTMA/UGMA custodian is permitted to withdraw funds only in accordance with applicable UTMA/UGMA law.
- The custodian may not change a beneficiary except in a manner consistent with UTMA/UGMA.
- The custodian may not designate a successor purchaser, unless in accordance with UTMA/UGMA.

KAPT shall not be liable to any purchaser, beneficiary, or third party for any breach or violation of applicable UTMA/UGMA, nor shall KAPT be responsible for, or obligated to ascertain whether, any direction given to KAPT by the purchaser complies with UTMA/UGMA. Compliance with UTMA/UGMA is solely the responsibility of the purchaser. KAPT strongly urges you, if you are considering UTMA funds for purchase of a KAPT Contract, to review these matters and properly assess your legal obligations and your beneficiary's rights under UTMA/UGMA law.

## TAX CONSIDERATIONS.

**The following is a summary of certain federal income, gift, and estate tax consequences relating to the KAPT program with respect to a purchaser's payments to KAPT; Fund earnings and distributions from the Fund to eligible educational institutions; and in certain circumstances, to participants. This summary is not exhaustive of all potential tax consequences and is not intended as individual tax advice to any purchaser, beneficiary, or any other person. Applicable tax rules under federal and state law are complex, and certain rules are uncertain at present. Application of the tax rules may vary according to an individual's particular facts and circumstances. KAPT makes no representation or assurance, express or implied, that the Internal Revenue Service (IRS) or the Kentucky Revenue Department will accept the particular conclusions expressed in this summary.**

**You should consult a qualified tax advisor for questions about how the tax laws may affect your individual tax situation.**

KAPT was established, in part, to obtain federal income tax benefits provided under Internal Revenue Code Section 529 (26 U.S.C. 529). 26 U.S.C. 529 governs the federal tax treatment of qualified tuition programs and the tax consequences for purchasers and beneficiaries of such plans.

This summary is based on relevant provisions of 26 U.S.C. 529 in effect as of August 1, 2004. The U.S. Congress, the Treasury Department, the IRS, and state taxing authorities may take actions which would adversely affect the tax consequences described herein, and any such adverse effects may be retroactive. Final tax regulations concerning qualified tuition programs under 26 U.S.C. 529 have not been issued by the IRS, and if issued by the IRS, such final regulations may alter the tax consequences summarized in this Disclosure Statement.

KAPT has been designed and intends to be maintained as a "qualified tuition program" under 26 U.S.C. 529 to permit purchasers and their beneficiaries to qualify for federal and state tax benefits applicable to such programs. Federal income tax benefits applicable to qualified tuition programs include:

- (1) The program fund is exempt from federal income tax;
- (2) Earnings of the program fund with respect to a purchaser's prepaid tuition account are not includible in the taxable income of the purchaser or beneficiary; and
- (3) Amounts paid by the program fund to pay qualified higher education expenses of the beneficiary are not includible in taxable income.

In order to achieve these tax benefits, a prepaid tuition program must satisfy the conditions of 26 U.S.C. 529, namely:

- Purchases may only be made in cash;
- The program must provide separate accounting for each beneficiary;
- Purchasers and beneficiaries may not, directly or indirectly, direct investment of any contributions to the prepaid program (or earnings);
- Interests in the program may not be used as security for a loan; and
- The program must provide adequate safeguards to prevent contributions on behalf of a beneficiary in excess of the amount necessary to provide for qualified higher education expenses of the beneficiary.

Your KAPT account is comprised of two components: your contributions and the increase in tuition value over your contributions, referred to as "earnings." The part of any KAPT distribution which represents your contributions is

not taxable. The amount paid in excess of your contributions, generally, will not be taxable to the purchaser or beneficiary as long as withdrawals are used for the beneficiary's qualified higher education expenses.

You should retain receipts, invoices, or other documents and information adequate to substantiate that distributions from your prepaid tuition account were used for qualified higher education expenses because it is your responsibility to substantiate qualified higher education expenses.

Earnings not used for qualified higher education expenses must be included in the distributee's taxable income. For example, refunds to a purchaser are subject to income tax to the extent distributions exceed the purchaser's contributions. Also, there is an additional tax of 10% on any taxable distribution. In general, the additional 10% tax is imposed on earnings which are not used for a beneficiary's qualified higher education expenses. Exceptions from the 10% tax include:

- (1) Payment to a beneficiary (or the estate of the designated beneficiary) on or after the death of the designated beneficiary;
- (2) Payment attributable to the beneficiary's being disabled;
- (3) Payment made on account of scholarship, to the extent the amount of the payment does not exceed the amount of scholarship; and
- (4) Payment which is taxable only because the qualified education expenses were taken into account in determining the Hope or lifetime learning credit.

For more information about taxation of KAPT distributions, see IRS Publication 970 which is available at the IRS website, [www.irs.gov](http://www.irs.gov).

Your participation in another qualified tuition program may impact (and in certain circumstances reduce) the tax benefits available under KAPT. Also, Tax Code rules coordinate your KAPT benefits with Coverdell (Education) IRAs and Hope and lifetime learning tax credits; please discuss the possible impact of your KAPT benefits with your tax advisor.

KAPT is required to report to the IRS payments of tuition, educational expenses, and refunds to purchasers. You should be aware that following such distribution, KAPT will forward Form 1099-Q to the IRS and the distributee (purchaser or beneficiary, depending on distribution) for income tax reporting. The due date for filing Form 1099-Q is January 31 of the year following distribution. Form 1099-Q should be reviewed in preparation of the purchaser's (or beneficiary's) income tax return for the year of distribution from the KAPT program.

There are also important federal gift tax considerations under 26 U.S.C. 529. For example, payments to a qualified tuition program on behalf of a beneficiary are generally considered a completed gift for gift tax purposes. Since the purchase of a prepaid tuition account under a qualified tuition program is considered a completed gift, purchasers are potentially subject to federal gift tax depending on the amount of the gift. For instance, federal gift tax is not imposed on a purchaser for gifts to a beneficiary which do not exceed the annual gift tax exclusion amount with respect to such beneficiary (currently \$11,000, periodically adjusted for inflation); all gifts in a year to a single beneficiary are counted for this purpose. Purchasers should contact their tax advisor regarding any requirement to file gift tax returns with the IRS upon opening a KAPT account.

If a purchaser's amount paid to a qualified tuition program together with other gifts to the same beneficiary in that year exceeds the annual gift tax exclusion amount, the purchaser may elect to treat prepaid tuition purchases up to \$55,000 as having been made ratably over the five-year period beginning with the tax year of purchase by filing a federal gift tax return for that year. That is, if purchase of prepaid tuition benefits by any one individual to a single beneficiary in a single tax year is greater than \$11,000 for 2004 (\$22,000 for married couples), the purchaser may elect to account for the aggregate amount, for purposes of the gift tax annual exclusion amount, ratably over the five-year period beginning with 2004. The purchaser should also be aware that his applicable lifetime gift tax credit (\$1 million) may be applied to taxable gifts in excess of the annual gift tax exclusion amount. Be sure to consult your tax advisor to determine if these gift tax rules apply to you.

26 U.S.C. 529 also provides that no amount is includible in the taxable estate of any individual by reason of an interest in a qualified tuition program. In other words, generally speaking, a prepaid tuition account under a qualified tuition program will not be subject to federal estate tax on the death of the purchaser; however, 26 U.S.C. 529 provides that this exclusion from estate tax does not apply to amounts distributed on account of the beneficiary's death. Also, if a purchaser dies before the end of the five-year averaging period discussed above, the purchaser's taxable estate would include the portion of the original payment that is allocable to the years following the purchaser's death.

Neither 26 U.S.C. 529 nor IRS Proposed Regulations specifically address the tax consequences of a change in purchaser of a prepaid tuition account. Purchasers and successor purchasers should consult their tax advisors regarding estate, gift, and income tax consequences resulting from such changes.

Kentucky Income Tax. KAPT prepaid tuition accounts are exempt from Kentucky income tax. If distributions of earnings are made for qualified higher education expenses, the value of a purchaser's prepaid tuition account will not be included in computing Kentucky income tax of a purchaser or beneficiary. Contributions are not deductible for Kentucky income tax purposes.

#### 2001 TAX LAW.

The Economic Growth & Tax Relief Reconciliation Act of 2001 (EGTRRA) significantly enhanced tax benefits for 26 U.S.C. 529 qualified tuition programs. However, under EGTRRA, favorable tax provisions "sunset" or become ineffective after December 31, 2010, and become replaced with the law in effect prior to EGTRRA. EGTRRA results in tax-free qualified withdrawals for beneficiaries from prepaid tuition accounts; in contrast, under pre-EGTRRA law, prepaid tuition earnings paid from a qualified tuition program would be taxable to the purchaser's beneficiary upon payment of tuition. EGTRRA provisions became effective January 1, 2002. As a result, this tax issue merits careful consideration by each purchaser to determine how such legal changes and "sunset" provisions will impact each purchaser based on individual projected enrollment dates and any possible federal and Kentucky tax penalties.

**The statements contained in this summary are for informational purposes only; KAPT makes no representation, express or implied, that purchasers or any other person should rely on this summary. Individual tax situations vary greatly, and KAPT cannot provide legal or tax advice. Payment of any tax liability is the responsibility of the purchaser or beneficiary and not KAPT. Please consult a tax advisor concerning the legal or tax implications resulting from the purchase of a KAPT Contract.**

Information in this Disclosure Statement is subject to change without prior notice, and this Disclosure Statement may contain differences from previous Disclosure Statements delivered by KAPT to purchasers.

Please contact 1-888-919-KAPT if you have any questions or need further information about the KAPT program.

August 2004